RISK FACTORS

RISKS RELATED TO OUR BUSINESS:

WE HAVE A HISTORY OF OPERATING LOSSES, AND WE MAY NOT BE PROFITABLE IN THE FUTURE.

We have incurred significant losses since we began operations as a competitive telecommunications provider and expect to continue to incur losses in the future as we build our network. For the year ended December 31, 1999, we had operating losses of $49.7 million and a net loss of $61.8 million. As of December 31, 1999, we had an accumulated deficit of $79.8 million. We expect to experience losses during our network and service deployment, which will continue for the foreseeable future. Prolonged effects of generating losses without additional funding may restrict our ability to pursue our business strategy.

If we cannot achieve profitability from operating activities, we may not be able to meet:

- our capital expenditure requirements;
- our debt service obligations; or
- our working capital needs.

OUR HIGHLY LEVERAGED CAPITAL STRUCTURE LIMITS OUR ABILITY TO OBTAIN ADDITIONAL FINANCING AND COULD ADVERSELY AFFECT OUR BUSINESS IN SEVERAL OTHER WAYS.

The level of our outstanding debt greatly exceeds the level of our revenue and stockholders' equity. As of December 31, 1999, we had $125.8 million of long-term indebtedness outstanding, including $10.0 million outstanding under our senior credit facility and $114.7 million of senior notes outstanding. This indebtedness represented 103.5% of our total capitalization at that date. We may, and are also permitted under the terms of our debt instruments to, incur substantial indebtedness in the future.

Our large amount of indebtedness could significantly impact our business for the following reasons:

- it limits our ability to obtain additional financing to complete our roll-out plan, to develop new services or to otherwise respond to unanticipated competitive pressures;
- it means that we will need to dedicate a substantial portion of our operating cash flow to fund interest expense on our senior credit facility and our senior notes, thereby reducing funds available for working capital, capital expenditures or other purposes;
- it makes us vulnerable to interest rate fluctuations because our senior credit facility loans bear interest at variable rates;
- it limits our ability to compete with companies who are not as highly leveraged, especially those who may be able to price their service offerings at levels below those we can or are willing to match; and
- it limits our ability to expand into new markets and to react to changing market conditions, changes in our industry and economic downturns.

OUR EXISTING DEBT INCLUDES RESTRICTIVE AND FINANCIAL COVENANTS THAT LIMIT OUR OPERATING FLEXIBILITY.

Our senior credit facility and the indenture relating to our senior notes contain covenants that, among other things, restrict our ability to take specific actions, even if we believe them to be in our best interest. These include restrictions on our ability to:

- incur additional debt;

- pay dividends or distributions on, or redeem or repurchase, capital stock;

- create liens or negative pledges with respect to our assets;

- make investments, loans or advances;

- issue, sell or allow distributions on capital stock of specified subsidiaries;

- enter into sale and leaseback transactions;

- prepay or defease specified indebtedness;

- enter into transactions with affiliates;

- enter into specified hedging arrangements;

- merge, consolidate or sell our assets; or

- engage in any business other than telecommunications.

The senior notes also require us to offer to purchase these notes from the holders at 101% if we undergo a change of control. In addition, the senior credit facility imposes financial covenants that require us to comply with specified financial ratios and tests, including minimum revenues, minimum EBITDA/maximum EBITDA losses, minimum access lines, senior secured debt to total capitalization, maximum capital expenditures, maximum leverage ratios, minimum interest coverage ratios and pro forma debt service coverage ratios. We cannot assure you that we will be able to meet these requirements or satisfy these covenants in the future. If we fail to do so, our debts could become immediately payable at a time when we are unable to pay them. This could adversely affect our ability to carry out our business plan and would have a negative effect on our financial condition.

WE EXPECT TO GROW AND CANNOT GUARANTEE THAT WE WILL BE ABLE TO EFFECTIVELY MANAGE OUR FUTURE GROWTH.

If we successfully implement our business plan, our operations will expand rapidly, and we will be providing packaged telecommunications services on a widespread basis. This could place a significant strain on our management, operational, financial and other resources and increase demands on our systems and controls. Failure to manage our future growth effectively could adversely affect the expansion of our customer base and service offerings. We cannot assure you that we will successfully implement and maintain efficient operational and financial systems, procedures and controls or successfully obtain, integrate and manage the employees and management, operational, financial and other resources necessary to manage a developing and expanding business in our evolving, highly regulated and increasingly competitive industry.

TO EXPAND AND DEVELOP OUR BUSINESS WE WILL NEED A SIGNIFICANT AMOUNT OF CASH, WHICH WE MAY BE UNABLE TO OBTAIN.

The expansion and development of our business and the deployment of our networks, services and systems will require significant capital expenditures, working capital and debt service and generate negative operating cash flows.

The actual amount and timing of our future capital requirements may differ materially from our estimates as a result of, among other things, the demand for our services and regulatory, technological and competitive developments, including additional market developments and new opportunities, in our industry. Our revenue and costs may also be dependent upon factors that are not within our control, including regulatory and legislative developments, the response of our competitors to their loss of customers to us and to changes in technology, the nature and penetration of services that we may offer and the number of subscribers and the services for which they subscribe. Due to the uncertainty of

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these factors, actual revenues and costs may vary from expected amounts, possibly to a material degree, and these variations are likely to affect our future capital requirements.

We also expect that we will require additional financing or may require financing sooner than anticipated to complete our roll-out plan or if our development plans change or prove to be inaccurate. We may also require additional financing in order to develop new services or to otherwise respond to changing business conditions or unanticipated competitive pressures. Sources of additional financing may include commercial bank borrowings, vendor financing, or the private or public sale of equity or debt securities. If we decide to raise additional funds through the incurrence of debt, our interest obligations will increase, and we may become subject to additional or more restrictive financial covenants, which could impair our ability to develop our business. We cannot assure you that we will be successful in raising sufficient additional capital on favorable terms or at all. Failure to raise sufficient funds may require us to modify, delay or abandon some of our future expansion or expenditure plans.

RESISTANCE BY POTENTIAL CUSTOMERS TO ACCEPT US AS A NEW PROVIDER OF TELECOMMUNICATIONS SERVICES MAY REDUCE OUR ABILITY TO INCREASE OUR REVENUE.

The success of our service offerings will depend upon, among other things, the willingness of additional customers to accept us as a new provider of integrated communications services. We cannot assure you that we will be successful in overcoming the resistance of potential customers to change their service provider, particularly those that purchase services from the traditional telephone companies, or that customers will buy our services. Any lack of customer acceptance would reduce our ability to increase our revenue.

IF WE ARE UNABLE TO DEVELOP OR INTEGRATE OUR SYSTEMS OR PROPERLY MAINTAIN AND UPGRADE THEM, WE MAY NOT BE ABLE TO BILL OUR CUSTOMERS EFFECTIVELY OR PROVIDE ADEQUATE CUSTOMER SERVICE.

Sophisticated back office information and processing systems are vital to our growth and our ability to monitor costs, bill customers, provision customer orders, achieve operating efficiencies and maintain our operating margins. Our plans for the development and implementation of these systems rely, for the most part, on choosing products and services offered by third party vendors and integrating these products and services in-house to produce efficient operational solutions. We cannot assure you that we will successfully implement these systems on a timely basis or that we will implement them at all. We also cannot assure you that, once implemented, these systems will perform as we expect. Risks to our business associated with our systems include:

- failure by these vendors to deliver their products and services in a timely and effective manner and at acceptable costs;

- failure by us to identify all of our information and processing needs adequately;

- failure of our related processing or information systems; or

- failure by us to effectively integrate new products or services.

Furthermore, as our suppliers revise and upgrade their hardware, software and equipment technology, we could encounter difficulties in integrating this new technology into our business or the new systems may not be appropriate for our business. In addition, our right to use these systems depends upon license agreements with third party vendors. Vendors may cancel or elect not to renew some of these agreements, which may adversely affect us.

WE MAY NEED TO RELY ON THE ESTABLISHED LOCAL TELEPHONE COMPANIES TO IMPLEMENT OUR SERVICES SUCCESSFULLY. THEIR FAILURE TO COOPERATE WITH US COULD ADVERSELY AFFECT THE SERVICES WE OFFER.

We are a recent entrant into the local telecommunications services industry. The local exchange services market in most states was only recently opened to competition. There are numerous operating complexities associated with providing these services. We will be required to develop new products, services and systems and will need to develop new marketing initiatives to sell these services. We cannot assure you that we will be able to develop these products and services.

We plan to deploy high capacity voice and data switches in most of the markets we serve. We initially intend to rely on the networks of established telephone companies or those of new market entrants for some aspects of transmission. Federal law requires most of the traditional local telephone companies to lease or "unbundle" elements of their networks and permit us to purchase the elements we need, thereby decreasing our operating expenses. We cannot assure you that this unbundling will continue to occur in a timely manner or that the prices for these elements will be favorable to us. Our current strategy depends in large part on our ability to provide service to our customers by leasing all of the network elements necessary to provide local telephone service from the incumbent telephone company rather than through the use of our own equipment and facilities. UNE-P allows us to minimize capital expenditures and permits us to enter new markets quickly, while allowing us to maintain significant gross margins. If the incumbent local telephone companies do not cooperate in making UNE-P available, our ability to provide service to customers could be materially adversely affected.

In addition, our ability to implement successfully our services will require the negotiation of interconnection and collocation agreements with established telephone companies and other new market entrants, which can take considerable time, effort and expense and is subject to federal, state and local regulation. Interconnection agreements are agreements between local telecommunications services providers that set forth the terms and conditions governing how those providers will interconnect their networks and/or purchase or lease network facilities and services.

Our interconnection agreements with Southwestern Bell provide that our connection and maintenance orders will receive the same attention as Southwestern Bell's end-user customers and that Southwestern Bell will provide capacity at key telecommunications intersections to keep call blockage within industry standards. Accordingly, we depend and will continue to depend on Southwestern Bell and, as we expand our network, we will depend on other traditional telephone companies to assure uninterrupted service and competitive services. Blocked calls result in customer dissatisfaction and risk the loss of business. Interconnection agreements, such as our agreements with Southwestern Bell, typically have short terms, requiring us to renegotiate frequently. Some of our agreements with Southwestern Bell have one year or less remaining before we will have to renegotiate them. We cannot assure you that we will be able to renegotiate these interconnection agreements in our existing markets, or negotiate new interconnection agreements in new markets, on favorable terms. In addition, the prices set forth in our interconnection agreements may be subject to significant rate increases at the discretion of the regulatory authority in each state in which we operate. Our profitability partially depends on these state-regulated rate structures. We cannot assure you that the rates charged to us under the interconnection agreements will allow us to offer low enough usage rates to attract a sufficient number of customers and to operate our business profitably or at favorable gross margins.

Many new carriers have experienced difficulties in working with the established telephone companies with respect to ordering, interconnecting, leasing premises and implementing the systems used by these new carriers to order and receive unbundled network elements and wholesale services. We cannot assure you that established telephone companies will be accommodating to us. If we are unable to obtain the cooperation of an established telephone company in a region, our ability to offer local services in this region on a timely and cost-effective basis would be adversely affected. In addition,

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both proposed and recently completed mergers involving regional Bell operating companies and other competitors could facilitate a combined entity's ability to provide many of the services we offer, thereby making it more difficult to compete against them.

DIGITAL SUBSCRIBER LINE TECHNOLOGY MAY NOT OPERATE AS EXPECTED ON INCUMBENT LOCAL CARRIER NETWORKS AND MAY INTERFERE WITH OR BE AFFECTED BY OTHER TRANSPORT TECHNOLOGIES.

Our ability to provide digital subscriber line services to potential customers depends on the quality, physical condition, availability and maintenance of telephone lines within the control of the incumbent carriers. If the telephone lines are not adequate, we may not be able to provide digital subscriber line services to many of our target customers, and this will diminish our expected revenue. We believe the current condition of telephone lines in many cases may be inadequate to permit us to fully implement these services. We also believe that the incumbent carriers may not maintain or improve the telephone lines in a condition that will allow us to implement our digital subscriber line services effectively. Further, the incumbent carriers may claim their lines are not of sufficient quality to allow us to fully implement or operate our digital subscriber line services. In addition, some customers use technologies other than copper lines to provide telephone services, and as a result, digital subscriber line services might not be available to these customers.

All transport technologies using copper telephone lines have the potential to interfere with, or to be interfered with by, other traffic on adjacent copper telephone lines. This interference could degrade the performance of our services or make us unable to provide service on selected lines. In addition, incumbent carriers may claim that the potential for interference by digital subscriber line technology permits them to restrict or delay our deployment of this technology. The telecommunications industry and regulatory agencies are still developing procedures to resolve interference issues between telecommunications providers, and these procedures may not be effective. We may be unable to successfully negotiate interference resolution procedures with incumbent carriers. Interference, or claims of interference, if widespread, would adversely affect our speed of deployment, reputation, brand image, service quality and customer retention and satisfaction.

IF WE ARE UNABLE TO ATTRACT AND RETAIN KEY MANAGEMENT AND PERSONNEL, WE MAY NOT BE ABLE TO IMPLEMENT OUR BUSINESS PLAN.

We believe that our future success will be due, in part, to our experienced management team, including Messrs. Scott, Goldman, Hollingsworth, Lawhon, Moline, Shackelford and Vranicar, each of whom is party to an employment agreement. Losing the services of one or more members of our management team could adversely affect our business and our expansion efforts and possibly prevent us from:

- further deploying and improving our operational, financial and information systems and controls;
- hiring and retaining qualified sales, marketing, administrative, operating and technical personnel; and
- training and managing new personnel.

In addition, competition for qualified employees has intensified in recent years and may become even more intense in the future. Our ability to implement our business plan depends on our ability to hire and retain a large number of new employees each year. Inability to hire sufficient qualified personnel could impair our ability to increase revenue, and customers could experience delays in installation of service or experience lower levels of customer care.

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WE MAY NOT HAVE THE ABILITY TO DEVELOP STRATEGIC ALLIANCES OR TO MAKE OR SUCCESSFULLY INTEGRATE ACQUISITIONS NEEDED TO COMPLEMENT OUR EXISTING BUSINESS.

As part of our growth strategy, we seek to develop strategic alliances and to make investments or acquire assets or other businesses. We regularly engage in discussions relating to potential acquisitions. We are unable to predict whether or when any prospective acquisitions or strategic alliances will occur or the likelihood of a material transaction being completed on favorable terms and conditions. Our ability to finance acquisitions and strategic alliances may be constrained by our degree of leverage at the time of the acquisition. In addition, our senior credit facility and senior notes may significantly limit our ability to make acquisitions or enter into strategic alliances and to incur indebtedness in connection with acquisitions and strategic alliances.

In addition, if we were to proceed with one or more significant strategic alliances, acquisitions or investments in which the consideration consists of cash, we could use a substantial portion of our available cash, to consummate the strategic alliances, acquisitions or investments. The financial impact of acquisitions, investments and strategic alliances could cause substantial fluctuations in our quarterly and yearly operating results.

The integration of any future acquisitions or strategic alliances would be accompanied by the risks commonly encountered in these transactions. These risks include, among others:

- the difficulty of assimilating the acquired operations and personnel;

- the potential disruption of our ongoing business and diversion of resources and management time;

- the inability of management to maximize our financial and strategic position by the successful incorporation of licensed or acquired technology and rights into our service offerings;

- the possible inability of management to maintain uniform standards, controls, procedures and policies;

- the risks of entering markets in which we have little or no direct prior experience; and

- the potential impairment of relationships with employees or customers as a result of changes in management or otherwise arising out of these transactions.

We cannot assure you that we will be able to integrate acquired businesses or assets successfully.

A SYSTEM FAILURE COULD CAUSE DELAYS OR INTERRUPTIONS OF SERVICE, WHICH COULD CAUSE US TO LOSE CUSTOMERS.

Our success will require that our networks provide competitive reliability, capacity and security. Some of the risks to our networks and infrastructure include:

- physical damage to access lines;

- power surges or outages;

- capacity limitations;

- software defects;

- lack of redundancy; and

- disruptions beyond our control.

These disruptions may cause interruptions in service or reduced capacity for customers, any of which could cause us to lose customers.

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ALL YEAR 2000 PROBLEMS MAY NOT HAVE BEEN ADDRESSED BY OUR SUPPLIERS, AND ANY SERVICE INTERRUPTION WE EXPERIENCE AS A RESULT OF THESE PROBLEMS MAY CAUSE US TO LOSE CUSTOMERS.

The Year 2000 issue generally describes the various problems that may result from the improper processing of dates and date-sensitive transactions by computers and other equipment as a result of computer hardware and software using two digits, rather than four digits, to identify the year in a date. Any computer programs or systems of our suppliers that have date-sensitive software may recognize a date using "00" as the year 1900 rather than the year 2000. While we have experienced no Year 2000 issues to date, and we are not aware of any material issues for our suppliers, we are continuing to evaluate and determine whether our significant suppliers are in compliance or have appropriate plans to remedy Year 2000 issues when their systems interact with our systems. We do not expect that this will have a material impact on our operations. However, we cannot assure you that the systems of other companies on which we rely are Year 2000 compliant, that another company's failure to successfully convert, or that another company's conversion to a system incompatible with our systems, would not have an impact on our operations. The failure of our principal suppliers to be Year 2000 compliant could result in delays in service deliveries from those suppliers and materially impact our ability to do business.

OUR OFFICERS AND DIRECTORS EXERT SUBSTANTIAL INFLUENCE OVER US.

Our executive officers, directors and entities affiliated with them together beneficially own a substantial percentage of our outstanding common stock. As a result, these stockholders are able to exercise substantial influence over all matters requiring approval by our stockholders, including the election of directors and approval of significant corporate transactions. This concentration of ownership may also have the effect of delaying or preventing a change in our control.

RISKS RELATED TO OUR INDUSTRY:

WE MAY NOT BE ABLE TO COMPETE EFFECTIVELY AGAINST OTHER COMPANIES.

The telecommunications industry is highly competitive and is affected by the introduction of new services by, and the market activities of, major industry participants. Several of our competitors are substantially larger and have greater financial, technical and marketing resources than we do. We have not achieved, and do not expect to achieve, a significant market share for any of the broadband telecommunications services we offer in our target markets. In particular, larger competitors have advantages over us that could cause us to lose customers and impede our ability to attract new customers, including:

- long-standing relationships and brand recognition with customers;

- financial, technical, marketing, personnel and other resources substantially greater than ours;

- more funds to deploy telecommunications services;

- potential to lower prices of competitive telecommunications services; and

- fully-deployed networks.

We face competition from other current and potential market entrants, including:

- domestic and international long distance providers seeking to enter, re-enter or expand entry into the local telecommunications marketplace; and

- other domestic and international telecommunications providers, resellers, cable television companies, electric utilities and Internet companies.

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A continuing trend toward combinations and strategic alliances in the telecommunications industry could give rise to significant new competitors. This could cause us to lose customers and impede our ability to attract new customers.

FCC AND STATE REGULATIONS MAY LIMIT THE SERVICES WE CAN OFFER OR IMPACT OUR ABILITY TO CONDUCT OUR BUSINESS.

Our networks and the provision of telecommunications services are extensively regulated at the federal, state and local levels. Existing and future governmental regulations may greatly influence how we operate our business, our business strategy and ultimately, our viability. The costs of complying with federal, state and local regulations and the delays in receiving required regulatory approvals or the enactment of new adverse regulation or regulatory requirements may be greater than we anticipate and divert our resources from implementing our business plan. We cannot predict the future regulatory framework for our business.

Our provision of telecommunications services may be subject to the requirement that we obtain proper authorizations from the FCC or state commissions. We cannot assure you that the FCC or state commissions will grant the required authority or refrain from taking action against us if we are found to have provided services without obtaining the necessary authorizations. If we do not fully comply with the rules of the FCC or state regulatory agencies, third parties or regulators could challenge our authority to do business. These challenges could cause us to incur substantial legal and administrative expenses.

Federal law governing the telecommunications industry remains in a state of flux. The Telecommunications Act remains subject to judicial review and additional FCC rulemaking, and thus it is difficult to predict what effect the legislation or these FCC rules will have on us and our operations. There are currently many regulatory actions underway and being contemplated by federal and state authorities regarding interconnection pricing, universal service support, access charge reform, and other issues that could result in significant changes to the business conditions in the telecommunications industry.

Our current business strategy depends in large part on our ability to provide service to our customers through UNE-P. Our ability to provide service to customers through UNE-P depends in turn on FCC and state commission rulings requiring incumbent local telephone companies to lease us the necessary network elements. If those rules are changed by the FCC or state commissions, or are struck down by the courts, our ability to provide service to our customers through UNE-P could be materially adversely affected. For example, the FCC could remove one or more of the necessary elements from the list of elements that the incumbent telephone companies are required to provide to us. The FCC could also expand the scope of an existing exception in its rules that permits incumbent telephone companies to opt not to make UNE-P available in the highest density geographic areas within the largest 50 metropolitan statistical areas if they meet certain conditions. If the FCC acts to expand the scope of the geographic exception to include our target markets, our business could be materially adversely affected. Some states in our current operating region, including Texas and Missouri, have gone beyond the FCC's minimum requirements and independently ordered Southwestern Bell to make UNE-P available throughout those states under terms more favorable to new telecommunications service providers than those required by the FCC. We cannot assure you that those favorable state rulings will remain in place. If UNE-P does not continue to be available on the favorable terms ordered by the states, our business could be materially adversely affected.

The United States Court of Appeals for the Eighth Circuit is currently considering challenges to the pricing methodology established by the FCC for setting the rates paid by telecommunications service providers to incumbent telephone companies for access to network elements. If the court strikes down some or all of the FCCs's pricing methodology and that methodology is ultimately replaced with

a methodology that imposes higher rates for network elements, we could be materially adversely affected.

Federal universal service support mechanisms could increase the costs of providing service to our customers. We derive revenue from the provision of interstate and international telecommunications services to end users that may be subject to the requirement that we contribute to the FCC's Universal Service Fund based on a percentage of this revenue. The assessment for the first quarter of 2000 is 5.8995%, and the assessment for the second quarter of 2000 is 5.7101% of interstate and international end user telecommunications revenue. The contribution factor varies quarterly at a rate set by the FCC. To the extent the contribution factor increases, our costs of providing service will increase.

Our Internet operations are not currently regulated directly by the FCC or any other governmental agency, other than regulations applicable to businesses generally. However, the FCC has recently indicated that the regulatory status of some services offered over the Internet may have to be re-examined. New laws or regulations relating to Internet services, or existing laws found to apply to them, may adversely affect our Internet operations.

WE MAY BE UNABLE TO ADAPT TO TECHNOLOGICAL CHANGE.

The telecommunications industry is subject to rapid and significant changes in technology, including continuing developments in digital subscriber line technology. This technology does not presently have widely accepted standards, and alternative technologies for providing high speed data transport and networking may develop. The absence of widely accepted standards may delay or increase the cost of our market entry due to changes in equipment specifications and customer needs and expectations. We may also rely on a third party for access to new technologies. In addition, if we acquire new technologies, we may not be able to implement them as effectively as other companies with more experience with those technologies and in their markets.

WE MAY FAIL TO ACHIEVE ACCEPTABLE PROFITS ON OUR LONG DISTANCE BUSINESS DUE TO DECLINING PRICES, LOW CUSTOMER RETENTION RATES AND OUR CONTRACTUAL OBLIGATIONS.

Prices in the long distance business have declined substantially in recent years and are expected to continue to decline. In addition, the long distance industry has a low customer retention rate, as customers frequently change long distance providers in response to the offering of lower rates or promotional incentives by competitors. We will rely on other carriers to provide us with a major portion of our long distance transmission network. Agreements with these carriers typically provide for the resale of long distance services on a per-minute basis and may contain minimum volume commitments. The negotiation of these agreements involves estimates of future supply and demand for transmission capacity, as well as estimates of the calling patterns and traffic levels of our future customers. In the event that we fail to meet these minimum volume commitments, we may have to pay underutilization charges, and, in the event we underestimate our need for transmission capacity, we may have to obtain capacity through more expensive means.

AS A NEW DATA TRANSMISSION ENTRANT IN A MARKET, WE MAY INITIALLY GENERATE LOW OR

NEGATIVE GROSS MARGINS.

As a new entrant in the data transmission business, we expect to generate low or negative gross margins and substantial start-up expenses as we begin to offer data transmission services. The success of our data transmission business will depend upon, among other things, the effectiveness of our sales personnel in the promotion and sale of our data transmission services, the acceptance of these services by potential customers, and our ability to hire and train qualified personnel and further enhance our services in response to future technological changes. We cannot assure you that we will be successful in these endeavors.

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THIS FORM 10-K CONTAINS FORWARD-LOOKING STATEMENTS THAT MAY NOT BE ACCURATE INDICATORS OF OUR FUTURE PERFORMANCE.

This Form 10-K contains forward-looking statements within the meaning of the federal securities laws. Discussions containing forward-looking statements may be found in the material set forth in this section and under "Business" and "Management's Discussion and Analysis of Financial Condition and Results of Operations," as well as in the Form 10-K generally. The words "believe," "estimate," "expect," "intend," "anticipate," "plan," and similar expressions and variations of these expressions identify some of these forward-looking statements that speak only as of the dates on which they were made. We caution you that these forward-looking statements are not guarantees of future performance and involve risks and uncertainties. Actual events or results may differ materially from those discussed in the forward-looking statements as a result of various factors, including, without limitation, the risk factors set forth above and the matters set forth in this Form 10-K generally. All subsequent written and oral forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the cautionary statements included in this document. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

ITEM 2. PROPERTIES

We lease 43,783 square feet in office space in Kansas City, Missouri for our corporate headquarters. This lease expires December 2006. Recently, we leased an additional 64,546 square feet of office space in Kansas City to expand our corporate headquarters. This lease expires February 2008. In Emporia, Kansas, we own two buildings totaling 58,500 square feet for our customer care center and provisioning divisions. In addition, we lease an aggregate of 21,175 square feet to house our four circuit switches in Kansas City and St. Louis, Missouri and Wichita, Kansas. These leases expire March 2003, November 2008, August 2005 and June 2008. We also lease space in 27 buildings, totaling approximately 110,823 square feet, in Missouri, Kansas, Texas and Oklahoma for our sales offices and customer premises equipment sites. These leases are generally leased on a month-to-month or annual basis.

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ITEM 3. LEGAL PROCEEDINGS

From time to time, we may be involved in claims or litigation that arise in the normal course of business. We are not a party to any legal proceedings which, if decided adversely, would have a material adverse effect on our business or financial condition or results of operations.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

MARKET INFORMATION

There is no established public trading market for our common stock. However, on March 23, 2000, we filed a registration statement on Form S-1 with the Securities and Exchange Commission, contemplating our initial public offering in the second quarter of 2000.

HOLDERS

As of March 23, 2000, there were 81 holders of record of our common stock.

DIVIDENDS

We have never paid or declared any cash dividends on our common stock and do not anticipate paying cash dividends in the foreseeable future. We currently intend to retain all future earnings, if any, for use in the operation of our business and to fund future growth. The terms of our senior credit facility and senior notes indenture restrict our ability to declare and pay dividends on our common stock.

RECENT SALES OF UNREGISTERED SECURITIES

During 1999 we issued the following securities which were not registered under the Securities Act of 1933, as amended.

In February 1999, we acquired American Local, a competitive local exchange carrier based in the Dallas, Texas metropolitan area. The acquisition included substantially all assets of American Local. The total purchase price was approximately $1.6 million in cash and $211,000 in stock representing 70,334 shares. This issuance was exempt from registration pursuant to Section 4(2) of the Securities Act.

During July 1999 we completed a private placement to approximately 55 of our existing investors in our series B preferred stock of 2,222,222 shares of series D preferred stock at a purchase price of $4.50 per share for aggregate net proceeds of approximately $10 million. This issuance was exempt from registration pursuant to Section 4(2) of the Securities Act.

During August 1999, BTI Ventures, L.L.C., an affiliate of KKR, purchased 13,333,334 shares of our series F preferred stock at a purchase price of $4.50 per share for aggregate net proceeds of $60.0 million. On March 23, 2000, KKR exercised its options to purchase an additional 5,263,158 shares of series F preferred stock at $4.75 per share and 5,000,000 shares of series F preferred stock at $5.00 per share. In connection with the private placement of the series F preferred stock to BTI Ventures, L.L.C., which closed on August 5, 1999, and the related exercise of the KKR options, Lehman Brothers

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Inc. earned compensation which included 646,300 shares of our series D preferred stock. These issuances were exempt from registration pursuant to Section 4(2) of the Securities Act.

During August 1999, in connection with the series F preferred stock offering, we repurchased 2,222,222 shares of our series C preferred stock for $10 million from a board member.

During August 1999, in connection with the series F preferred stock offering, we converted each outstanding share of series B preferred stock into one share of amended and restated series B preferred stock. The holders of series B preferred stock, approximately 70 accredited investors, surrendered their existing redemption and participating liquidation preference in exchange for 0.2222 shares of our series E preferred stock. These issuances were exempt from registration pursuant to Section 4(2) of the Securities Act. We redeemed the series E preferred stock for a total of $8.6 million.

In March 1999, Mr. Jalkut, a member of our board of directors, agreed to purchase 26,667 shares of our common stock for $200,000, and Mr. Ejabat, a member of our board of directors, agreed to purchase 66,667 shares of our common stock for $500,000.

ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth our selected consolidated financial and operating data for the periods indicated. Our statement of operations data and other financial data for the years ended December 31, 1997, 1998 and 1999 and our balance sheet data as of December 31, 1998 and 1999, as well as the statement of operations data, other financial data and balance sheet data for the predecessor company as of and for the year ended December 31, 1997, have been derived from, and is qualified by reference to, consolidated financial statements included elsewhere in this Form 10-K.

EBITDA consists of earnings before interest, income taxes, depreciation and amortization. EBITDA is provided because it is a measure of financial performance commonly used in the telecommunications industry. EBITDA is used by management and some investors as an indicator of a company's historical ability to service debt. Management believes that an increase in EBITDA is an indicator of improved ability to service existing debt, to sustain potential future increases in debt and to satisfy capital requirements. We have presented EBITDA to enhance your understanding of our operating results. You should not construe it as an alternative to operating income, as an indicator of our operating performance nor as an alternative to cash flows from operating activities as a measure of liquidity determined in accordance with GAAP. We may calculate EBITDA differently from other companies. For further information, see our consolidated financial statements and the related notes elsewhere in this prospectus.

The predecessor company is Valu-Line, which merged with us in February 1998. Prior to February 1998, Birch had no revenues and was a development stage company.

We acquired Boulevard, Telesource and TFSnet in 1998 and American Local and Capital in 1999. The statement of operations data, other financial data and operating data in the table include the operations of these companies beginning on the dates they were acquired. These acquisitions affect the comparability of the financial data for the periods presented.

For purposes of calculating the ratio of earnings to fixed charges, earnings are defined as loss before income taxes plus fixed charges. Fixed charges consist of interest expense and a reasonable approximation of the interest factor included in rental payments on operating leases. Earnings were insufficient to cover fixed charges for the years ended December 31, 1997, 1998 and 1999. See Exhibit 12.1 for the computation of the ratio of earnings to fixed charges.

	YEAR ENDED DECEMBER 31,					
	THE PREDECESSOR			BIRCH		
	1995	1996	1997	1997	1998	1999
	(IN THOUSANDS, EXCEPT PER SHARE AND OPERATING DATA)					
STATEMENT OF OPERATIONS DATA:						
Revenue	$12,226	$13,217	$16,801	$ --	$ 26,087	$ 60,538
Cost of services	8,284	8,749	11,842	--	18,886	46,358
Gross margin	3,942	4,468	4,959	--	7,201	14,180
Selling, general and administrative	3,520	3,561	4,067	1,776	15,769	53,045
Depreciation and amortization	189	311	341	27	2,308	10,828
Income (loss) from operations	233	596	551	(1,803)	(10,876)	(49,693)
Interest income (expense), net	(58)	(102)	(97)	14	(5,332)	(12,111)
Income (loss) before income taxes	175	494	454	(1,789)	(16,208)	(61,804)
Provision for income taxes	81	205	186	--	--	--

Net income (loss)	$ 94	$ 289	$ 268	(1,789)	(16,208)	(61,804)
Preferred stock dividends				--	(1,696)	(3,550)
Amortization of preferred stock issuance costs				--	(29)	(292)
Loss applicable to common stock				$(1,789)	$(17,933)	$(65,646)
Weighted average shares outstanding--basic and diluted				1,235	3,809	4,956
Loss per common share--basic and diluted				$ (1.45)	$ (4.71)	$ (13.25)
OTHER FINANCIAL DATA:						
Cash flows from operating activities	$ (267)	$ 834	$ 488	$(1,551)	$(10,643)	$(53,225)
Cash flows from investing activities	(230)	(513)	(243)	(128)	(67,093)	(31,796)
Cash flows from financing activities	259	(257)	(145)	1,889	117,271	50,329
EBITDA	422	907	892	(1,776)	(8,568)	(38,865)
Capital expenditures	230	513	243	128	21,550	41,360
Ratio of earnings to fixed charges	3.5x	5.2x	4.9x	--	--	--
Deficiency of earnings to fixed charges	--	--	--	1,789	16,208	61,804
OPERATING DATA:						
Local Customers at end of period				--	14,735	38,487
Access Lines in service at end of period				--	39,323	112,518
Average lines per business customer				--	4.73	4.48
Average lines per residential customer				--	1.25	1.22
Circuit switches in service at end of period				1	1	4
Data switches in service at end of period				--	1	19
Employees at end of period				14	345	935

	DECEMBER 31,					
	THE PREDECESSOR			BIRCH		
	1995	1996	1997	1997	1998	1999
			(IN THOUSANDS)			
BALANCE SHEET DATA:						
Cash and cash equivalents	$ 96	$ 158	$ 258	$ 210	$ 39,745	$ 5,053
Pledged securities	--	--	--	--	37,785	23,420
Property and equipment	2,265	2,721	2,964	128	26,900	70,192
Total assets	3,971	3,868	4,802	534	134,149	146,971
Long-term debt and capital lease obligations	1,431	792	681	--	115,791	125,785
Redeemable preferred stock	--	--	--	--	14,063	63,550
Total stockholders' equity (deficit)	1,108	1,397	1,665	29	(7,099)	(67,757)

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

YOU SHOULD READ THE FOLLOWING DISCUSSION OF OUR FINANCIAL CONDITION AND RESULTS OF OPERATIONS TOGETHER WITH THE FINANCIAL STATEMENTS AND RELATED NOTES THAT ARE INCLUDED LATER IN THIS FORM 10-K. THIS DISCUSSION CONTAINS FORWARD-LOOKING STATEMENTS THAT INVOLVE RISKS AND UNCERTAINTIES. OUR ACTUAL RESULTS MAY DIFFER MATERIALLY FROM THOSE ANTICIPATED IN THESE FORWARD-LOOKING STATEMENTS AS A RESULT OF VARIOUS FACTORS, INCLUDING THOSE SET FORTH UNDER "RISK FACTORS" OR IN OTHER PARTS OF THIS FORM 10-K.

OVERVIEW

We were organized on December 23, 1996 to become a leading provider of telecommunications services for small and mid-sized businesses in our target markets. From that date until the February 1998 acquisition of Valu-Line, our predecessor, we were a development stage company with no revenue and principal activities consisting of procuring governmental authorizations, raising capital, hiring management and other key personnel, designing and developing our telephone networks, acquiring equipment and facilities, negotiating resale and interconnection agreements and pursuing acquisition opportunities. We had no assets, liabilities or financial activity prior to January 1, 1997.

The following is a summary of our major transactions and events.

DATE	EVENT

- - ---- ---------	---
February 1998	Merged with Valu-Line Companies, Inc., a provider of switched long distance, resold services and customer premises equipment sales and service in Kansas.
February/March 1998 preferred portion of debt and	Raised $13.0 million from the issuance of series B stock and convertible notes used to pay the cash the consideration in the Valu-Line merger, to repay for general corporate purposes.
March 1998	Launched St. Joseph, Missouri market.
May 1998 metropolitan	Acquired Boulevard Phone Company, a provider of shared tenant service in the Kansas City, Missouri area.
May 1998 City,	Acquired Telesource Communications, Inc., a customer equipment sales and service provider in the Kansas Missouri metropolitan area.
May 1998 Wichita and	Launched St. Louis and Kansas City, Missouri and Topeka, Kansas markets.
June 1998 senior	Completed a $115.0 million private offering of 14% notes due June 2008 and 115,000 warrants to purchase 1,409,734 shares of common stock.
September 1998 in the	Acquired TFSnet, Inc., a provider of Internet service Kansas City, Missouri metropolitan area.
February 1999 based in	Acquired American Local, a communications provider the Dallas, Texas metropolitan area.
March 1999 Louis,	Acquired Capital Communications Corporation, a customer equipment sales and service provider based in the St. Missouri metropolitan area.
May 1999-August 1999	Launched 11 Texas markets.
July 1999/August 1999 additional	Sold $60.0 million of series F preferred stock to an affiliate of KKR, granted options to purchase an $50.0 million of series F preferred stock, sold $10.0 million of series D preferred stock and redeemed $10.0 million of series C preferred stock and $8.6 million of series E preferred stock.
December 1999/February 2000 corporate and $125.0	Obtained a $75.0 million debt facility for general purposes of our subsidiaries and to finance telecommunications equipment, inventory, network assets back office systems. The facility was increased to million during syndication in February 2000.

March 2000	KKR exercised its options to purchase an additional $50.0 million series F preferred stock.
March 2000 for	Filed a registration statement on Form S-1 with the SEC
stock.	an underwritten initial public offering of common

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FACTORS AFFECTING OPERATIONS

REVENUE. We generate most of our revenue from the sale of our voice and data products, including local and long distance telephone service, Internet access and customer premises equipment to small and mid-sized business customers in various markets in Missouri, Kansas and Texas. Revenue from local services consists of charges for basic local service and custom calling features. We offer local telephone service at a discount to the competing incumbent provider of telecommunications services and offer long distance service at flat per-minute rates. We offer customer premises equipment and related services at negotiated rates generally consistent with other competitors. We also offer data services in select markets primarily at flat monthly rates. We expect that over the near term these services will continue to be the principal components of our revenue.

Our revenue consists of monthly recurring charges and usage charges. Monthly recurring charges include the fees paid by our customers for lines in service, additional features on those lines and collocation space. Usage charges consist of fees paid for each call made generally measured by the minute but also measured by the call. Additionally, revenue from customer premises equipment sales is recognized upon project completion.

OPERATING EXPENSES. Our primary operating expenses are cost of services and selling, general and administrative expenses.

COST OF SERVICES. Our cost of services includes the cost of leasing unbundled network elements from the incumbent telephone company for combination into Birch-branded voice services and purchasing the complete "bundle" of traditional incumbent telephone company services for resale to our local service subscribers. We lease local telephone network components to provide service for our customers under an interconnection agreement with the incumbent telephone company in our target markets. In markets where we have a local circuit switch, we can avoid leasing the switch and related features from the incumbent telephone company, which improves our gross margins.

Incumbent telephone companies typically charge both a start-up fee as well as a monthly recurring fee for use of their central offices for collocation of transmission equipment. Physically collocating our transmission equipment in or near existing incumbent telephone company switching offices allows us to combine leased digital subscriber lines with our data transmission switches to provide high speed data services and, eventually, voice and data services over a single digital subscriber line. We also invest in transmission and distribution electronics equipment associated with our switches. All of these costs are reflected in our cost of services.

Our primary long distance expenses are expenses associated with network access and our leased long distance network. We purchase long distance capacity from third party providers for all calls terminating outside of our network.

Our primary expense associated with providing data services to our customers is the cost of leasing transmission facilities. Our primary expense associated with customer premises equipment is the cost of purchasing equipment from manufacturers and labor for service and equipment installation.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES. Our selling, general and administrative expenses include selling and marketing costs and customer service, billing, corporate administration, personnel and network maintenance expenses.

We employ a direct sales force in each of our target markets. To attract and retain a highly qualified sales force, we offer our sales personnel a compensation package that emphasizes commissions. We expect to incur significant selling and marketing costs as we expand our operations.

We have implemented and continue to refine tailored systems for operations support systems and other back office systems that provision and track customer orders from point of sale to the installation

and testing of service. Along with the development costs of these systems, we also incur ongoing expenses for customer service and billing systems. As our strategy stresses the importance of personalized customer service, we expect that our customer service department will become a larger part of our ongoing administrative expenses. We also expect billing costs to increase as the number of our customers and the call volume increase. We incur other costs and expenses, including the costs associated with maintenance of our network, administrative overhead, office leases and bad debt. We expect that these costs will grow significantly as we expand our operations and that administrative overhead will be a large portion of these expenses during the expansion phase of our business. However, we expect these expenses to become a smaller percentage of our revenue as we build our customer base.

We have experienced operating losses since inception as a result of efforts to build our customer base, develop and construct network infrastructure, build internal staffing, develop systems and expand into new markets. We expect to continue to focus on increasing our customer base and geographic coverage. Accordingly, we expect that cost of services, selling, general and administrative expenses, and capital expenditures will continue to increase significantly, all of which may have a negative impact on operating results. The projected increases in capital expenditures will continue to generate negative cash flows for at least the next several years as we develop and construct our voice and data networks. We may also be forced to change our pricing policies to respond to a changing competitive environment, and we cannot assure you that we will be able to maintain our gross and operating margins. We cannot assure you that growth in our revenue or customer base will continue or that we will be able to achieve or sustain profitability or positive cash flows.

RESULTS OF OPERATIONS

BIRCH TELECOM, INC.

YEAR ENDED DECEMBER 31, 1999 COMPARED TO YEAR ENDED DECEMBER 31, 1998

REVENUE. Revenue increased 132.1% to $60.5 million for 1999 compared to $26.1 million for 1998. The increase in revenue was principally a result of new customer sales in new and existing markets and the acquisitions of Capital in March 1999 and American Local in February 1999. As a percentage of total revenue, communications services were 87.5% for 1999 and 83.5% for 1998, and equipment sales were 12.5% for 1999 and 16.5% for 1998.

COST OF SERVICES. Cost of services increased 145.5% to $46.4 million for 1999 compared to $18.9 million for 1998. The increase in cost of services was primarily the result of associated revenue increases. Gross margins increased 96.9% to $14.2 million (23.4% of revenue) for 1999 compared to $7.2 million (27.6% of revenue) for 1998. The decline in gross margin as a percentage of revenue was principally the result of a greater percentage of revenue being derived from resold local service during 1999 compared to 1998. Additionally, long distance margins declined as a result of competitive pricing pressures.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES. Selling, general and administrative expenses increased 236.4% to $53.0 million for 1999 compared to

$15.8 million for 1998. The increase in expense was primarily a result of supporting and attracting customers in new and existing markets, market launches in Texas and the acquisitions of Capital and American Local each of which affected wages, rent and advertising expense. Additionally, we had 935 employees at December 31, 1999 compared to 345 employees at December 31, 1998. EBITDA, a commonly used measure by securities analysts of earnings before deducting interest, taxes, depreciation and amortization, decreased 353.6% to a loss of $38.9 million for 1999 compared to a loss of $8.6 million for 1998.

DEPRECIATION AND AMORTIZATION. Depreciation and amortization increased 369.2% to $10.8 million for 1999 compared to $2.3 million for 1998. The increase in depreciation and amortization was

primarily attributable to the depreciation of network assets added in our markets and the amortization of intangible assets related to acquisitions.

INTEREST. Interest expense increased 82.2% to $15.0 million for 1999 compared to $8.3 million for 1998. The increase in interest expense was primarily a result of a full year of interest charges on our senior notes sold in June 1998. Interest income remained virtually unchanged at $2.9 million in 1999 and 1998. Interest income is primarily derived from pledged securities purchased in connection with our senior notes.

NET LOSS. Net loss increased 281.3% to $61.8 million for 1999 compared to $16.2 million for 1998.

YEAR ENDED DECEMBER 31, 1998 COMPARED TO YEAR ENDED DECEMBER 31, 1997

REVENUE. Revenue was $26.1 million for 1998, resulting from the acquisitions of Valu-Line, Boulevard, Telesource and TFSnet and new customer sales from new markets. There was no revenue for 1997 because we were in the developmental stage. In addition to revenue generated as a result of acquisitions in 1998, revenue was generated from the sale of local telephone services to new customers.

COST OF SERVICES. Cost of services and gross margin totaled $18.9 million and $7.2 million, respectively, for 1998 as a result of the associated revenue increases.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES. Selling, general and administrative expenses increased $14.0 million to $15.8 million for 1998 compared to $1.8 million for 1997. The increase in expense was primarily a result of the Valu-Line, Boulevard, Telesource and TFSnet acquisitions and opening five new markets in 1998. Additionally, we expanded our engineering and operations staff in preparation for switch deployment. EBITDA decreased 382.4% to a loss of $8.6 million for 1998 compared to a loss of $1.8 million for 1997.

DEPRECIATION AND AMORTIZATION. Depreciation and amortization increased to $2.3 million for 1998 compared to $27,000 for 1997, most of which was attributable to the fixed and intangible assets acquired in the Valu-Line, Boulevard, Telesource and TFSnet acquisitions.

INTEREST. Interest expense was $8.2 million for 1998 primarily from interest charges on the senior notes. There was no interest expense in 1997. Interest income was $2.9 million in 1998 compared to $14,000 for 1997 primarily as a result of invested funds received from the senior notes.

NET LOSS. Net loss was $16.2 million for 1998 compared to $1.8 million for 1997.

VALU-LINE COMPANIES, INC. (PREDECESSOR COMPANY)

YEAR ENDED DECEMBER 31, 1997 COMPARED TO YEAR ENDED DECEMBER 31, 1996

REVENUE. Revenue increased 27.1% to $16.8 million for 1997 compared to

$13.2 million for 1996. The increase was primarily a result of entering the local service market in March 1997 and long distance volumes increasing faster than the decline in long distance pricing. Customer premises equipment sales were 18% of revenue, or $3.0 million, for 1997 compared to 19.1% of revenue, or $2.5 million, for 1996.

COST OF SERVICES. Cost of services increased 35.4% to $11.8 million for 1997 compared to $8.7 million for 1996. The increase was primarily a result of associated revenue increases. Gross margin increased 11.0% to $5.0 million, or 29.5% of revenue, for 1997 compared to $4.5 million, or 33.8% of revenue, for 1996. The decrease in gross margin as a percentage of revenue was primarily a result of low margins on resold local service, which started in March 1997.

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SELLING, GENERAL AND ADMINISTRATIVE EXPENSES. Selling, general and administrative expenses increased 14.2% to $4.1 million for 1997 compared to $3.6 million for 1996. The increase in expense was primarily a result of sales commissions related to increased business volumes and increased customer service expenditures associated with the commencement of local service. EBITDA decreased 1.7% to $892,000 for 1997 compared to $907,000 for 1996. The decrease in EBITDA was primarily a result of the start-up costs associated with offering local service.

DEPRECIATION AND AMORTIZATION. Depreciation and amortization increased 9.6% to $341,000 for 1997 compared to $311,000 for 1996.

INTEREST EXPENSE. Interest expense was $97,000 for 1997 compared to $102,000 for 1996.

INCOME TAXES. Income taxes decreased 9.3% to $186,000 for 1997 compared to $205,000 for 1996.

NET INCOME. Net income was $268,000 for 1997 compared to $289,000 for 1996.

LIQUIDITY AND CAPITAL RESOURCES

Our total assets increased to $147.0 million at December 31, 1999 from $134.1 million at December 31, 1998. This increase was primarily the result of capital outlays for expansion of our local and data networks and development of operations support systems and automated back office systems, partially offset by the use of cash to fund operations. At December 31, 1999, our current assets of $38.8 million exceeded current liabilities of $25.4 million, resulting in working capital of $13.4 million, representing a decrease of $36.3 million compared to working capital of $49.7 million at December 31, 1998. At December 31, 1998, our current assets of $61.1 million exceeded current liabilities of $11.4 million. The decrease in working capital was primarily attributable to the use of cash to fund operations and capital outlays for expansion of our network, support systems and back office systems. Pledged securities to satisfy interest payments on our senior notes amounted to $23.4 million at December 31, 1999 and $37.8 million at December 31, 1998.

OPERATING ACTIVITIES. Net cash used in operating activities was $53.2 million for the year ended December 31, 1999 compared to $10.6 million for the year ended December 31, 1998. Net cash used in operating activities was primarily used to fund our net losses of $61.8 million in 1999 and $16.2 million in 1998.

INVESTING ACTIVITIES. Net cash used in investing activities was $31.8 million for the year ended December 31, 1999 compared to $67.1 million for the year ended December 31, 1998. In 1999, net cash used in investing activities was primarily used for the purchase of property and equipment related to the expansion of our networks, support systems and back office systems of $41.4 million and acquisitions of $4.8 million, partially offset by net proceeds from the sale of pledged securities of $16.1 million for the semi-annual interest payments on the senior notes. In 1998, net cash used in investing activities was primarily used for the purchase of pledged securities related to our senior notes of $44.2 million, acquisitions of $7.8 million and purchases of property and equipment related to the expansion of the network, support systems and back office systems of $21.6 million, partially offset by net proceeds from the sale of pledged securities of $7.7 million.

FINANCING ACTIVITIES. Net cash provided by financing activities was $50.3 million for the year ended December 31, 1999 compared to $117.3 million for the year ended December 31, 1998. In 1999, net cash provided by financing activities was primarily a result of $70.0 million in proceeds from the sale of series D and series F preferred stock and borrowings of $10.0 million under our senior credit facility, partially offset by the redemption of series C and series E preferred stock of $18.6 million and the payment of financing costs related to the series D and series F preferred stock and on our senior credit facility of $8.8 million.

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In 1998, net cash provided by financing activities was primarily a result of proceeds of $114.7 million from the private offering of our senior notes. These senior notes bear interest at a fixed rate of 14% per annum and are due in June 2008. Subject to limitations, we may redeem a portion of these senior notes prior to their maturity date if we pay a designated premium. The indenture with respect to the senior notes contains a number of restrictive financial and operational covenants with which we must comply.

In February 2000, we increased the capacity of our $75.0 million senior credit facility to $125.0 million. This credit facility provides for a $25.0 million reducing revolver and $100.0 million in multi-draw term loans. The revolver is available for general corporate purposes of our subsidiaries and the term loans are to be used to finance telecommunications equipment, inventory, network assets and back office systems. The senior credit facility is secured by a perfected first priority security interest in substantially all of our assets and capital stock of our subsidiaries and contains a number of financial and operational covenants with which we must comply. Among other things, the covenants require us to maintain specified levels of revenue, EBITDA, ratio levels and access lines and restrict our ability to incur additional indebtedness, pay dividends, enter into related party transactions or sell our assets.

In March 2000, KKR exercised its options to purchase an additional $50.0 million of our series F preferred stock.

The development and expansion of our business will continue to require significant capital to fund capital expenditures, working capital and debt service and will generate negative operating cash flows.

Our principal capital expenditure requirements will include:

- the purchase, installation, and expansion of switches and transmission equipment for our local and data networks; and

- the further development of operations support systems and automated back office systems.

We do not believe that the growth of our long distance and customer premises equipment business will require significant capital expenditures.

Our business plan calls for us to offer our services in an additional 20 markets before the end of 2001. We expect to expand our operations in Texas and into Oklahoma in the second quarter of this year and to commence service in the regions served by Ameritech and BellSouth in 2001. We currently estimate that the cash required to fund these capital expenditures will be approximately $225.0 million over the next two years. We will need additional cash to fund our working capital needs, debt service requirements and operating losses. Until we begin to generate positive cash flow from operations, these liquidity requirements will need to be financed with additional debt and equity capital. In addition, depending on prevailing capital market conditions, we may choose to repurchase all or a portion of our senior notes. We believe that our current resources, including availability under our senior credit facility, together with the net proceeds from our proposed initial public offering, planned for the second quarter of 2000, will be sufficient to satisfy our liquidity needs for at least the next 12 months.

Thereafter, we will need substantial additional capital to finance our business plan. If our plans or assumptions change, if our assumptions prove to be inaccurate, or if we experience unexpected costs or competitive pricing pressures, we will be required to seek additional capital sooner than we currently expect. In particular, if we elect to pursue acquisition opportunities or open additional markets, our cash needs may increase substantially. We cannot assure you that our current projection of cash flow and losses from operations, which will depend upon numerous future factors and conditions, many of which are outside of our control, will be accurate. Actual results will almost certainly vary materially from our current projections. The cost of expanding our network services and sales efforts, funding

other strategic initiatives and operating our business will depend on a variety of factors, including, among other things:

- the number of subscribers and the services for which they subscribe;
- the nature and penetration of services that we may offer;
- regulatory and legislative developments; and
- the response of our competitors to their loss of customers to us and to changes in technology.

We intend to seek additional debt and equity financing to fund our future liquidity needs. We cannot assure you that we will be able to raise additional capital on satisfactory terms or at all. If we decide to raise additional funds through the incurrence of debt, our interest obligations will increase and we may become subject to additional or more restrictive financial covenants. In addition, the terms of our senior credit facility and our senior notes each restrict our ability to obtain additional debt financing. If we decide to raise additional funds through the issuance of equity, the ownership interests represented by the common stock will be diluted. In the event that we are unable to obtain additional capital or to obtain it on acceptable terms or in sufficient amounts, we may be required to delay the development of our network and business plans or take other actions that could materially and adversely affect our business, operating results and financial condition.

IMPACT OF THE YEAR 2000 ISSUE

The Year 2000 issue results from computer programs being written using two digits rather than four to define the year. Any of our computer programs or systems, or those of our suppliers, that have date-sensitive software may recognize a date using "00" as the year 1900 rather than the year 2000. This could result in a system failure or miscalculation causing the disruption of operations, including among other things:

- a temporary inability to process transactions;
- a temporary inability to send invoices;
- a temporary inability to engage in normal business activities; and
- interruptions of customer care.

We did not experience any problems on January 1, 2000 and to date, we have not experienced, nor are we aware of, any material Year 2000 issues with any of our internal systems or our services, and we do not anticipate experiencing any issues in the future. Further, we are unaware of any issues with our vendors, suppliers or customers that will materially affect us.

We believe that we have identified all major computers, software applications and related equipment used in connection with our internal operations that will need to be modified, upgraded or replaced to minimize the possibility of a material disruption to our business. We have completed assessing the potential impact of Year 2000 issues on these computers, equipment and applications and have modified, upgraded and replaced major systems that we believe have Year 2000 issues.

In addition to computers and related information, operation, and network systems, the operation of office systems, facilities and equipment, such as fax machines, security systems and other common office devices, may have Year 2000 issues that have not yet surfaced. We will continue to monitor the performance of these office systems, equipment and facilities.

We expect that we will be able to resolve any significant Year 2000 issues we have identified with third party suppliers of components of telecommunications services and our key subcontractors. However, because we have no control over the actions of these parties, they may not remediate any or all of the Year 2000 issues identified. Any failure of any of these third parties to timely resolve Year

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2000 issues with either their products sold to us, or their systems could have a material adverse effect on our business, operating results and financial condition. In addition, the delivery of our services also depends on the operation of the networks of many local exchange carriers and long distance carriers with whom we must interact as part of our normal business operations, but with whom we do not have formal contractual arrangements. Consequently, failure of these carriers' networks to fully operate as a result of Year 2000 issues could also affect our operations. To our knowledge, none of these networks experienced any problems on or since January 1, 2000.

Our total cost to date to proactively address our Year 2000 issues has not been material. The cost of addressing Year 2000 issues is reported as a general and administrative expense.

We believe we identified and resolved all Year 2000 issues that could materially and adversely affect our business operations. However, for the reasons discussed above, we believe that it is not possible to determine with complete certainty that all Year 2000 issues affecting us have been identified or corrected and we may not know that this is true for several months. As a result, we believe that the following consequences are possible:

- operational inconveniences and inefficiencies for us that will divert our management's time and attention and our financial and human resources from ordinary business activities;
- business disputes and claims for pricing adjustments or penalties by our customers due to Year 2000 issues, which we believe will be resolved in the ordinary course of business; and
- business disputes alleging that we failed to comply with the terms and conditions of contracts or industry standards of performance that result in litigation or contract termination.

We developed contingency plans to be implemented if our efforts to identify and correct Year 2000 issues affecting our internal systems were ineffective. We have adopted the Year 2000 contingency plans as our standard operational contingency plans. Our contingency plans are designed to minimize the disruptions or other adverse effects. Our plans include:

- accelerated replacement of affected equipment or software;
- short to medium-term use of backup equipment and software;

- increased work hours for our personnel; and

- use of contract personnel to correct on an accelerated schedule any Year 2000 issues that arise or to provide manual workarounds for information systems.

Our implementation of any of these contingency plans could require us to expend additional funds and could have a material adverse effect on our business, operating results and financial condition. Our efforts in this regard, if necessary, will be to minimize expense associated with the implementation and use of any contingency planning with our objective to employ the least costly plan necessary to address the relevant operational issues.

IMPACT OF INFLATION

We do not believe that inflation has had a significant impact on our consolidated operations.

SEASONALITY

Our business is not considered to be seasonal.

RECENTLY ISSUED ACCOUNTING STANDARDS

In June 1998, the FASB issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," which supersedes SFAS No. 80, "Accounting for Futures Contracts," SFAS No. 105,

"Disclosure of Information About Financial Instruments with Off-Balance-Sheet Risk and Financial Instruments with Concentration of Credit Risk," and SFAS No. 119, "Disclosures about Derivative Financial Instruments and Fair Value of Financial Instruments," and also amends some aspects of other SFAS's previously issued. SFAS No. 133 establishes accounting and reporting standards for derivative instruments and hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the balance sheet and measure those instruments at fair value. SFAS No. 133 is effective for our consolidated financial statements for the year ending December 31, 2001. We do not expect the impact of SFAS No. 133 to be material in relation to our consolidated financial statements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We do not have operations subject to risks of foreign currency fluctuations, nor do we use derivative financial instruments in our operations or investment portfolio. Our earnings are affected by changes in interest rates as our long-term debt under our senior credit facility has variable interest rates based on either the prime rate or LIBOR. Our exposure to variable interest rate risk during 1999 was insignificant due to our level of floating rate borrowings. However, if interest rates for our long-term debt under our senior credit facility had averaged 10% more and the full amount available under our senior credit facility had been outstanding for the entire year, our interest expense would have increased, and loss before taxes would have increased by $12.5 million for the year ended December 31, 1999. These amounts are determined by considering the impact of the hypothetical interest rates on our borrowing cost and outstanding debt balances. These analyses do not consider the effects of the reduced level of overall economic activity that could existing in this environment. Further, in the event of a change of this magnitude, management would likely take actions to further mitigate our exposure to the change. However, due to the uncertainty of the specific actions that would be taken and their possible effects, the sensitivity analysis assumes no changes in our financial structure. We had $114.7 million of senior notes outstanding as of December 31, 1999. These notes bear interest at a fixed rate of 14% and are not subject to risk from interest rate fluctuations.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

For information required by Item 8, refer to the consolidated financial statements included in the Financial Statements and Financial Statement Schedule section filed as part of this document.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

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PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

DIRECTORS, EXECUTIVE OFFICERS AND OTHER KEY EMPLOYEES

The following table sets forth information concerning our directors, executive officers and other key personnel, including their ages as of March 23, 2000:

NAME	AGE	POSITION
Richard A. Jalkut......................	56	Chairman of the Board
David E. Scott.........................	40	President, Chief Executive Officer and Director
Donald H. Goldman......................	40	Executive Vice President and Chief Operating Officer
David M. Hollingsworth.................	35	Senior Vice President of Financial Operations
Gregory C. Lawhon......................	40	Senior Vice President of Public Policy and General Counsel
Bradley A. Moline......................	33	Senior Vice President of Finance and Chief Financial Officer
Jeffrey D. Shackelford.................	39	Senior Vice President of Sales
David W. Vranicar......................	41	Senior Vice President and Chief Information Officer
Henry H. Bradley.......................	54	Director
Adam H. Clammer........................	29	Director
Mory Ejabat............................	49	Director
James H. Greene, Jr....................	49	Director
Henry R. Kravis........................	55	Director
Alexander Navab, Jr....................	33	Director
Thomas R. Palmer.......................	33	Director
George R. Roberts......................	56	Director

RICHARD A. JALKUT is our chairman of the board and has been a director since March 2000. Since 1997, he has been president and chief executive officer of Pathnet, a privately held telecom company. From 1994 to 1997, Mr. Jalkut was the president, chief executive officer and chairman of the board of Nynex Telecommunications Group. From 1991 to 1994, he was the president, chief executive officer and chairman of the board of New York Telephone Company, and from 1990 to 1991, he was the executive vice president and chief operating officer.

DAVID E. SCOTT, a co-founder and director, is also our president and chief executive officer. Mr. Scott has 17 years of managerial experience in the telecommunications industry. Prior to joining us, Mr. Scott was president and general manager of Kansas City FiberNet, a competitive local exchange carrier owned jointly by the country's two largest cable operators, TCI and Time Warner. Prior to his tenure at Kansas City FiberNet, Mr. Scott was vice president of strategic development for Sprint, responsible for developing investment plans in the competitive local exchange, wireless (PCS) and international marketplaces. Mr. Scott also served as director of strategic planning for Sprint from 1988 to 1991. Mr. Scott also serves as a director of BizSpace, Inc., an Internet publishing and E-commerce company he co-founded with Donald H. Goldman. BizSpace, Inc. produces web sites that serve as on-line trade publications. Their first website, www.clec.com, serves the competitive local exchange carrier industry. Mr. Scott holds a Bachelor of Science degree in electrical engineering, SUMMA CUM LAUDE, from the University of Missouri and a Master of Business Administration degree from the University of Chicago.

DONALD H. GOLDMAN joined us in March 1998 as senior vice president of Internet services and is currently our executive vice president and chief operating officer. Mr. Goldman has over 15 years of managerial experience in the telecommunications industry. Prior to joining us, Mr. Goldman served as

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vice president, corporate development at Sprint where he developed strategy and managed the acquisition of companies in the areas of systems integration, Internet telephony, and wireless (PCS) services among others. While at Sprint, Mr. Goldman led the team that founded Sprint PCS. Mr. Goldman also serves as chairman of the board of BizSpace, Inc. Mr. Goldman holds a Bachelor of Arts degree, with honors, from Johns Hopkins University and a Master of Business Administration degree from the University of Chicago.

DAVID M. HOLLINGSWORTH joined us in February 2000 as senior vice president of financial operations. Prior to joining us, from 1998 to February 2000, Mr. Hollingsworth was the vice president of finance and corporate development for GST Telecommunications. From 1997 to 1998, Mr. Hollingsworth was a telecommunications analyst at George K. Baum and Company. From 1993 through 1996, Mr. Hollingsworth served as director of finance and administration for Kansas City FiberNet. Before FiberNet, Mr. Hollingworth was a mergers and acquisitions manager for Sprint Corporation. Mr. Hollingsworth holds a Bachelor of Arts in Business Administration, CUM LAUDE, from Washington State University.

GREGORY C. LAWHON joined us in January 1997 as senior vice president of public policy and general counsel. Prior to joining us, Mr. Lawhon practiced law for twelve years with the 90-lawyer Kansas City firm of Spencer Fane Britt & Browne. A partner in the firm since 1990, he was head of the firm's communications and media group and a member of its business group. Mr. Lawhon's areas of practice were mergers and acquisitions, with an emphasis on communications industry acquisitions, cable television franchising, and commercial and regulatory issues with respect to the telecommunications industry. Mr. Lawhon holds a Bachelor of Arts degree in Economics, MAGNA CUM LAUDE, from Vanderbilt University, and a law degree from Columbia University, where he was a Harlan Fiske Stone Scholar.

BRADLEY A. MOLINE joined us in July 1997 as senior vice president of finance and chief financial officer. From 1994 to 1997, Mr. Moline was the treasurer and chief financial officer of Covenant Transport, Inc., a transportation company in Chattanooga, Tennessee that became publicly traded during his tenure. Prior to joining Covenant Transport, Mr. Moline worked for Ernst & Young LLP in Kansas City, Missouri and Grant Thornton in Lincoln, Nebraska, providing customer services in the auditing and consulting areas. Mr. Moline holds a Bachelor of Administration degree in Business Administration, with distinction, from the University of Nebraska and is a certified public accountant.

JEFFREY D. SHACKELFORD, a co-founder, is senior vice president of sales. Mr. Shackelford has 13 years of experience in the telecommunications industry. Prior to joining us, Mr. Shackelford served as director of sales and marketing for Kansas City FiberNet. Prior to joining Kansas City FiberNet, Mr. Shackelford was the Branch Manager for Sprint's commercial sales office in Kansas City and was responsible for sales and service of small to large business customers. During his tenure at Sprint, which began in 1988, Mr. Shackelford also developed the long distance industry's first PC-based call management system, FONVIEW. Mr. Shackelford holds a Bachelor of Science degree in Computer Science from the University of Kansas.

DAVID W. VRANICAR joined us in March 1997 and serves as senior vice president and chief information officer. Prior to joining us, Mr. Vranicar was vice president, international business development, at Sprint. Before joining Sprint in 1992, Mr. Vranicar was vice president, Asia/Pacific operations, at MPSI Systems Private Ltd., based in Singapore. MPSI is a software and information services company that develops and markets decisions-support software and databases to major retail companies. Mr. Vranicar was the company's senior executive in the Asia/Pacific division, directing a staff of approximately 80 engaged in software development, computer graphics, and customer technical support. Mr. Vranicar holds a Bachelor of Business degree in Marketing, with honors, from the University of Texas at Austin, and a Master of Business Administration degree, with distinction, from the University of Michigan at Ann Arbor.

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HENRY H. BRADLEY has been a director since January 1997. He is the chairman of the board of News-Press & Gazette Company, or NPG, one of our co-founders. NPG is a family-owned company that owns and operates a daily newspaper, cable television systems, network affiliate broadcast television stations and FM and AM radio stations. Mr. Bradley has held a number of other positions with NPG since joining NPG in 1971, including terms as the editor and publisher of the St. Joseph News-Press. Mr. Bradley holds a Bachelor's degree from the University of Missouri.

ADAM H. CLAMMER has been a director since August 1999. Prior to joining KKR in 1995, he was with Morgan Stanley & Co. in its mergers and acquisitions department. At KKR, Mr. Clammer has been involved in investments in Intermedia Communications, Inc., CAIS Internet, Inc., Zhone Technologies, RELTEC and Borden. He is also a director of AEP Industries, Inc. and a number of private companies.

MORY EJABAT has been a director since March 2000. Since September 1999, Mr. Ejabat has been the chairman and chief executive officer of Zhone Technologies, Inc. Prior to joining Zhone, Mr. Ejabat served as the president and chief executive officer of Ascend Communications, Inc. from June 1995 to June 1999. Before becoming the president and chief executive officer of Ascend in 1995, Mr. Ejabat had served as vice president, operations from 1990 to 1992 and as executive vice president from 1992 to 1995.

JAMES H. GREENE, JR. has been a director since August 1999 and is a member of the limited liability company which serves as the general partner of KKR and a general partner of KKR Associates. He is also a director of Accuride Corporation, Owens-Illinois, Inc., Safeway Inc., Shoppers Drug Mart, Inc., Intermedia Communications, Inc., CAIS Internet, Inc., Tenovis, formerly a division of Bosch Telecom, and Zhone Technologies.

HENRY R. KRAVIS has been a director since March 2000. He is a founding partner of KKR and since January 1996 a managing member of the executive committee of the limited liability company that serves as the general partner of Kohlberg Kravis Roberts & Co., L.P. He is also a director of Accuride Corporation, Borden, Inc., The Boyds Collection, Ltd., Evenflo Company Inc., The Gillette Company, IDEX Corporation, KinderCare Learning Centers, Inc., KSL Recreation Group, Inc., Owens-Illinois, Inc., PRIMEDIA Inc., Regal Cinemas, Inc., Safeway, Inc., Sotheby's Holdings, Inc., Spalding Holdings Corporation, and TI Group plc. Messrs. Kravis and Roberts are first cousins.

ALEXANDER NAVAB, JR. has been a director since August 1999. He has been an executive of KKR and a limited partner of KKR Associates since 1993. From 1991 to 1993, Mr. Navab was an associate at James D. Wolfensohn, Inc. He is also a director of Borden, Inc., KSL Recreation Group, Inc., Intermedia Communications, Inc., CAIS Internet, Inc., Tenovis, formerly a division of Bosch Telecom, and Zhone Technologies.

THOMAS R. PALMER has been a director since April 1999. Since June 1997, Mr. Palmer has been a general partner at Kansas City Equity Partners, and focuses on investments in the telecommunications and information technology sector. He joined the firm in August 1995. Prior to joining Kansas City Equity Partners, he held positions at Ameritech and Trans National Group. Mr. Palmer also serves on the boards of Net Sales, Vroom and several other private companies. Mr. Palmer is a graduate of Dartmouth College and the Kellogg School of Management at Northwestern University.

GEORGE R. ROBERTS has been a director since March 2000. He is a founding partner of KKR and since January 1996 a managing member of the executive committee of the limited liability company that serves as the general partner of Kohlberg Kravis Roberts & Co., L.P. He is also a director of Accuride Corporation, Borden, Inc., The Boyds Collection, Ltd., Evenflo Company Inc., IDEX Corporation, KinderCare Learning Center, Inc., KSL Recreation Group, Inc., Owens-Illinois, Inc., PRIMEDIA Inc., Regal Cinemas, Inc., Safeway, Inc. and Spalding Holdings Corporation. Messrs. Kravis and Roberts are first cousins.

SECTION 16(A) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

During the year ended December 31, 1999, we did not have equity securities registered pursuant to Section 12 of the Exchange Act and this item is, therefore, non-applicable.

ITEM 11. EXECUTIVE COMPENSATION

DIRECTOR COMPENSATION

Directors who are also our executive officers do not receive any additional compensation for serving as members of the board of directors or any of its committees. Beginning in 2000, non-employee directors are expected to receive a cash stipend of $5,000 payable annually and reimbursement of expenses for serving on the board of directors and any committees of the board, as well as an annual option to purchase 5,000 shares of common stock. Each non-employee director currently on the board will receive an option to purchase 10,000 shares of common stock upon completion of our initial public offering at the offering price. These options will vest in equal annual installments over the next four years. In addition, Messrs. Ejabat and Jalkut each received on March 22, 2000 an additional option to purchase 30,000 shares of common stock at an exercise price of $7.50 per share. These options will vest in equal annual installments over the next two years.

COMPENSATION OF EXECUTIVE OFFICERS

The following table sets forth the cash and non-cash compensation paid or incurred on our behalf to our chief executive officer and each of the four other most highly compensated executive officers that earned more than $100,000 during 1999:

SUMMARY COMPENSATION TABLE

NAME AND PRINCIPAL POSITION	YEAR	ANNUAL COMPENSATION SALARY($)	BONUS($)	OTHER ANNUAL COMPENSATION($)	LONG-TERM COMPENSATION AWARDS SECURITIES UNDERLYING OPTIONS (#)(1)	ALL OTHER COMPENSATION ($)(2)
David E. Scott................	1999	203,846	--	--	200,000	8,153
President and Chief	1998	175,000	--	--	1,052,362	7,000
Executive Officer(3)	1997	164,904	--	--	--	--
Donald H. Goldman.............	1999	192,892	--	--	150,000	7,716
Executive Vice President	1998	101,346	--	--	263,750	--
and Chief	1997	--	--	--	--	--
Operating Officer(4)						
Gregory C. Lawhon.............	1999	184,615	--	--	75,000	7,385
Senior Vice President of	1998	175,000	--	--	328,863	5,386
Public Policy and General	1997	164,904	--	--	--	--
Counsel(3)						
David W. Vranicar.............	1999	177,331	--	--	75,000	7,093
Senior Vice President	1998	150,000	--	--	274,052	6,000
and Chief Information	1997	118,269	--	--	--	--
Officer(5)						
Stephen L. Sauder.............	1999	216,561	--	--	--	8,663
Vice President(6)	1998	226,471	--	--	--	--
	1997	134,577	128,667	--	--	--

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(1) Includes options to purchase shares of our common stock, which were issued under our 1998 employee stock option plan. Prior to the private placement of our series B preferred stock, we were a party to various stock option agreements with our employees, all of which were governed by our 1997 stock option plan. In connection with the 1998 private placement of series B preferred stock, the 1997 stock option plan was replaced with the 1998 stock option plan, and all stock option agreements governed by the 1997 stock option plan were terminated. Options issued to the members of management during 1998 were granted under our 1998 employee stock option plan and were exercisable immediately on grant at an exercise price of $0.001 per share. The shares issued under these options vest over a four-year period, at a rate of 6.25% per quarter. Options issued during 1999 were also granted under our 1998 stock option plan and vest 25% at the first anniversary of the grant, then 6.25% per quarter thereafter. All stock options have been adjusted to reflect a stock dividend made on June 23, 1998. Holders of exercised options have voting power with respect to all shares of common stock underlying the options. Upon termination of employment, we have the right to repurchase all options which have not vested as of that date, subject to some exceptions.

(2) Reflects matching contributions made by us under our 401(k) plan.

(3) Reflects compensation paid to Messrs. Scott and Lawhon commencing in January 1997.

(4) Mr. Goldman joined us in March 1998 as senior vice president of Internet services. In August 1999 Mr. Goldman was named senior vice president of operations and chief operating officer.

(5) Reflects compensation paid to Mr. Vranicar commencing in March 1997.

(6) Mr. Sauder joined us after the Valu-Line acquisition and currently serves as vice president. Compensation listed was paid by Valu-Line from January 1997 to February 1998.

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OPTIONS GRANTS

The following table sets forth summary information regarding option grants made during 1999 to our chief executive officer and each of our four other highly paid executive officers. The exercise price per share is equal to the fair market value of our common stock on the date of grant as determined by our board of directors:

	INDIVIDUAL GRANTS				POTENTIAL REALIZABLE VALUE AT ASSUMED ANNUAL RATES OF STOCK PRICE APPRECIATION FOR OPTION TERM(3)	
NAME	NUMBER OF SECURITIES UNDERLYING OPTIONS GRANTED(#)(1)	% OF TOTAL OPTIONS GRANTED TO EMPLOYEES IN FISCAL YEAR(2)	EXERCISE OR BASE PRICE ($/SHARE)	EXPIRATION DATE	5%($)	10%($)
David E. Scott	200,000	11.5%	4.50	10/7/09	566,005	1,434,368
Donald H. Goldman	50,000	2.8%	3.00	1/15/09	94,334	239,061
	150,000	8.4%	4.50	10/7/09	424,504	1,075,776
Gregory C. Lawhon	75,000	4.3%	4.50	10/7/09	212,252	537,888
David W. Vranicar	75,000	4.3%	4.50	10/7/09	212,252	537,888
Stephen L. Sauder	--	--	--	--	--	--

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(1) Options granted to purchase shares of our common stock were made under our

1998 employee stock option plan. In the event that a purchaser ceases to provide service to us and our affiliates, we have the right to repurchase any of that person's unvested shares of common stock at the original option exercise price. Generally, these options vest 25% on the first anniversary of the grant date and quarterly thereafter at a rate of 6.25%.

(2) The percentage of total options was calculated based on options to purchase an aggregate of 1,794,800 shares of common stock granted to employees under the 1998 stock option plan in 1999.

(3) The potential realizable value was calculated based on the ten-year term of the options and assumed rates of stock appreciation of 5% and 10%, compounded annually from the date the options were granted to their expiration date based on the fair market value of the common stock on the date of grant.

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1998 EMPLOYEE STOCK OPTION PLAN

Under our 1998 employee stock option plan, as amended, options to purchase shares of our common stock in the form of both incentive stock options and nonqualified stock options were granted to our employees or employees of certain of our subsidiaries. A total of 7,720,845 shares of our common stock were reserved for issuance under this option plan. As of December 31, 1999, options to acquire 2,030,850 shares were issued and outstanding with a weighted average exercise price of $3.57 per share. These options generally vest 25% per year over four years from the date of grant. Under a resolution of our board of directors, no new options may be granted under this option plan.

401(K) PLAN

We have adopted a tax-qualified employee savings and retirement plan, or 401(k) plan, covering all of our full-time employees. Under the 401(k) plan, employees may elect to reduce their current compensation up to the statutorily prescribed annual limit and have the amount of the reduction contributed to the 401(k) plan. The 401(k) plan is intended to qualify under Section 401 of the Code so that contributions by employees to the 401(k) plan and income earned on plan contributions are not taxable to employees until withdrawn from the 401(k) plan. The trustees under the 401(k) plan, at the direction of each participant, invest the participant's assets in the 401(k) plan in selected investment options.

1999 OPTION VALUES

The following table shows for the fiscal year ended December 31, 1999, information regarding options granted to, exercised by, and held at year end by, our chief executive officer and each of our four other most highly paid executive officers during 1999:

			NUMBER OF SECURITIES UNDERLYING UNEXERCISED OPTIONS (#)		VALUE OF UNEXERCISED IN-THE-MONEY OPTIONS ($)	
NAME	SHARES ACQUIRED ON EXERCISE (#) (1)	VALUE REALIZED ($) (2)	EXERCISABLE	UNEXERCISABLE (3)	EXERCISABLE	UNEXERCISABLE (2) (3)
David E. Scott	263,091	1,972,916	--	791,953	--	5,039,060
Donald H. Goldman	65,938	494,465	12,500	335,859	168,750	1,562,547
Gregory C. Lawhon	82,216	616,536	--	259,985	--	1,612,206
David W. Vranicar	68,513	513,779	--	229,154	--	1,381,003
Stephen L. Sauder	--	--	--	--	--	--

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(1) For purposes of this table alone, "exercise" means an employee's acquisition of shares of common stock which have already vested, "exercisable" means options to purchase shares of common stock which are subject to exercise and "unexercisable" means all other options to purchase shares of common stock.

(2) Amounts shown under the "Value Realized" and "Value of Unexercised In-the-Money Options" are based upon the estimated December 31, 1999 estimated fair market value of our common stock of $7.50 per share minus the per share exercise price multiplied by the number of shares underlying the option.

(3) Includes options to purchase shares of common stock, which were issued under the 1998 employee stock option plan. Options issued during 1998 under the 1998 employee stock option plan were granted at an exercise price of $0.001 per share. Options issued during 1999 under the 1998 stock

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option plan were granted at an exercise price of $4.50 per share. All options vest 25% on the first anniversary of the grant date and quarterly thereafter at a rate of 6.25%.

EMPLOYMENT AGREEMENTS

Each of Messrs. Scott, Goldman, Lawhon, Moline, Shackelford and Vranicar entered into an amended and restated employment agreement with us in October 1999. In addition, Mr. Sauder entered into an employment agreement with us in February 1998, and Mr. Hollingsworth entered into an employment agreement with us in February 2000.

The base salary under each of these agreements is $200,000 per year, except that Mr. Scott's base salary is $250,000 per year, Mr. Goldman's is $225,000 per year and Mr. Sauder's is $213,000 per year. Each of the executives is eligible for a bonus based on achievement of performance criteria established by the board for that executive.

Each of the employment agreements provides that upon termination of employment by us, other than for cause, disability or death, or termination of the employment by the executive for good reason, we will pay the executive the following severance. We will pay the executive's salary for the remainder, if any, of the calendar month in which the termination is effective and, in the case of each of Messrs. Scott, Vranicar, Shackelford and Goldman, 24 calendar months thereafter and, in the case of each of Messrs. Lawhon, Sauder, Hollingsworth and Moline, 12 calendar months thereafter. In addition, we will pay each executive his prorated targeted incentive compensation for the year during which the termination is effective plus, in the case of each of Messrs. Scott, Vranicar, Shackelford and Goldman, two times the executive's targeted incentive compensation for that year, and, in the case of each of Messrs. Lawhon, Hollingsworth and Moline, the full amount of the executive's targeted incentive compensation for that year. Upon termination of employment for disability, we will pay the employee's salary through the remainder of the calendar month during which the termination is effective and for the lesser of (1) six calendar months thereafter or (2) the period until disability insurance benefits commence. Upon termination of employment from death, we will pay the employee's salary through the end of the calendar month in which his death occurs. Each agreement provides for noncompetition, nonsolicitation and nondisclosure covenants.

COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

None of the members of the compensation committee of the board of directors is currently or has been, at any time since our formation, our officer or employee.

REPORT OF THE COMPENSATION COMMITTEE OF THE BOARD OF DIRECTORS

The following is a report of the Compensation Committee of our Board of Directors (Committee), describing the compensation policies applicable to our executive officers during the fiscal year ended December 31, 1999.

GENERAL POLICIES

The Committee is responsible for assisting the Chief Executive Officer (CEO) in devising general compensation policies and compensation plans, as well as the specific compensation levels for individual executive officers. The Committee also administers the stock option, employee stock purchase and 401(k) plans and determines the terms and conditions of grants thereunder. The Committee consists of Messrs. Bradley, Greene, Navab and Mr. Scott, Birch's CEO. Prior to his departure from the board in August 1999, Ian Bund was a member of the Committee. Mr. Scott does not participate in Committee deliberations or decisions involving his own compensation.

The goals of the Committee are to:

- align compensation with business objectives and performance;

- adopt policies that enable us to attract, retain and reward executive officers and other key employees who contribute to Birch's long-term success; and

- motivate executives and employees as we seek to enhance long-term stockholder value..

In order to meet these goals, the Committee has adopted the following policies:

- Offer pay that is competitive with the practices of the leading telecommunications companies with which compete for talent. To ensure that pay is competitive, the Committee regularly compares its pay practices with these companies and sets it pay parameters based on this review.

- Maintain annual incentive opportunities sufficient to provide motivation to achieve specific operating goals and to generate rewards that bring total compensation to competitive levels.

- Provide significant equity-based incentives for executives and other key employees to ensure that they are motivated over the long-term. The Committee wants Birch's executives and employees to respond to business challenges and opportunities as owners and not just as employees.

The compensation mix offered to employees reflects a balance of annual cash payments, consisting of base salary and incentive bonus payments and long-term stock-based incentives in the form of stock options.

BASE SALARIES

The salary component of executive compensation is based on the executive's level of responsibility for meeting targeted objectives and their overall performance. Base salaries for executives are reviewed and adjusted at least annually based on information regarding competitive salaries, the results of industry compensation surveys, individual experience and performance.

CASH BONUSES

Our incentive program for executive officers provides direct financial incentives in the form of cash bonuses based on previous year performance.

STOCK OPTIONS

The Committee's long-term incentive program is centered around the granting of stock options under the 1998 Stock Option Plan. These stock options, which typically have vesting periods of four years, encourage key employees to continue their service with Birch and motivate their performance. Executive officers receive significant equity incentives to build long-term stockholder value. Grants are made at 100% of fair market value on the date of grant. Employees receive value from these grants only if Birch's common stock appreciates over the long-term. The size of option grants is determined based on competitive practices at leading companies in the telecommunications industry and our philosophy of linking executive compensation with stockholder interests. The Committee believes this approach creates an appropriate focus on longer term objectives and promotes executive retention.

COMPENSATION OF THE CHIEF EXECUTIVE OFFICER

Mr. Scott has served as Birch's President and CEO since inception. In February 1998, Mr. Scott entered into an employment agreement, the terms of which are described in more detail in "Employment Agreements."

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During fiscal 1999, Mr. Scott received aggregate salary of $203,846, which reflects the August 1999 increase in Mr. Scott's base salary from $175,000 to $250,000. In addition, Mr. Scott was granted options to purchase an aggregate of 200,000 shares of our common stock in 1999. This compensation reflects the August 1999 increase in Mr. Scott's base salary from $175,000 to $250,000. Mr. Scott did not receive a cash bonus in 1999. In reviewing the compensation paid to Mr. Scott in 1999, the Committee considered a number of factors, including competitive market compensation packages, Mr. Scott's past performance and the responsibilities he has assumed as CEO. Based on its internal review and informal information reviewed by the Committee, the Committee believes that the base salary level for Mr. Scott is commensurate with salaries paid to chief executive officers of comparable companies in similar industries.

Overall, the Committee believes that Mr. Scott is being appropriately compensated in a manner that is consistent with the long-term interests of stockholders.

CONCLUSION

A significant portion of the Committee's compensation program, including Mr. Scott's compensation, are contingent on individual performance, and the realization of benefits is closely linked to increases in long-term stockholder value. The Committee remains committed to this philosophy of pay for performance, recognizing that the competitive market for talented executives and the volatility of the Company's business may result in highly variable compensation for a particular time period.

The members of the Committee submit the foregoing report.

COMPENSATION COMMITTEE:

Henry H. Bradley
James H. Greene, Jr.
Alexander Navab, Jr.
David E. Scott

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table provides summary information regarding the beneficial ownership of our outstanding capital stock as of March 23, 2000 for:

- each person or group who beneficially owns more than 5% of our capital stock on a fully diluted basis;

- each of the executive officers and the former executive officer named in the Summary Compensation Table;

- each of our directors; and

- all of our directors and executive officers as a group.

Beneficial ownership of shares is determined under the rules of the Securities and Exchange Commission and generally includes any shares over which a person exercises sole or shared voting or investment power. Except as indicated by footnote, and subject to applicable community property laws, each person identified in the table possesses sole voting and investment power with respect to all shares of common stock held by them. Shares of common stock subject to options currently exercisable or exercisable within 60 days of March 23, 2000 and not subject to repurchase as of that date are deemed outstanding for calculating the percentage of outstanding shares of the person holding these options, but are not deemed outstanding for calculating the percentage of any other person. Unless otherwise

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noted, the address for each director and executive officer is c/o Birch Telecom, Inc., 2020 Baltimore Avenue, Kansas City, Missouri 64108.

NAME AND ADDRESS OF BENEFICIAL OWNER (A)	NUMBER OF SHARES BENEFICIALLY OWNED				
		PREFERRED STOCK SERIES			
	COMMON STOCK (B)	B	C	D	F
DIRECTORS AND EXECUTIVE OFFICERS:					
Richard A. Jalkat (c)............	26,667	--	--	--	--
David E. Scott..................	1,190,768	--	189,900	--	--
Donald H. Goldman...............	263,750	--	--	--	5.5
Gregory C. Lawhon...............	380,137	49,453	--	--	--
Bradley A. Moline (d)............	297,932	74,509	--	--	--
Jeffrey D. Shackelford..........	794,162	--	126,600	--	--
David W. Vranicar...............	316,780	36,266	--	--	--
Henry H. Bradley (e)............	--	1,978,128	1,582,500	333,333	--
Adam H. Clammer (f) (1)...........	--	--	--	--	23,596,492
Mory Ejabat (c)	66,667	--	--	--	--
James H. Greene, Jr. (f) (1).......	--	--	--	--	23,596,492
Henry R. Kravis (f) (1)...........	--	--	--	--	23,596,492
Alexander Navab, Jr. (f) (1).......	--	--	--	--	23,596,492
Thomas R. Palmer (g) (m)..........	--	945,108	--	666,667	--
George R. Roberts (f) (1)..........	--	--	--	--	23,596,492
Stephen L. Sauder (h)............	--	85,719	4,089,575	--	--
All directors and executive officers as a group (16 persons)......................	3,336,862	3,169,183	5,988,575	1,000,000	23,596,492
5% OWNERS:					
News-Press & Gazette Company (i)..	--	1,648,438	1,582,500	222,222	--
Advantage Capital Missouri Partners I, L.P. (j)...........	--	1,318,750	--	145,550	--
Advantage Capital Missouri Partners II, L.P. (j)...........	--	--	--	417,450	--
Pacific Capital, L.P. (k).........	--	1,219,925	--	--	--
BTI Ventures L.L.C. (f) (1)........	--	--	--	--	23,596,492
Kansas City Equity Partners I, L.P. (g) (m)....................	--	945,108	--	111,111	--
Kansas City Equity Partners Ventures II, L.P. (g) (m).......	--	--	--	555,556	--
White Pines Limited Partnership I (n)..............	--	989,128	--	--	--
LBI Group, Inc. (o)..............	--	--	--	586,617	--

NAME AND ADDRESS OF BENEFICIAL OWNER (A)	PERCENTAGE OF CLASS OWNED	
		PREFERRED STOCK SERIES
	COMMON	

	STOCK (B)	B	C	D	F
DIRECTORS AND EXECUTIVE OFFICERS:					
Richard A. Jalkat(c)............	*	--%	--%	--%	--%
David E. Scott..................	24.9	--	3.0	--	--
Donald H. Goldman...............	5.68	--	--	--	--
Gregory C. Lawhon...............	8.0	*	--	--	--
Bradley A. Moline(d)............	6.2	--	--	--	
Jeffrey D. Shackelford..........	16.6	--	2.0	--	--
David W. Vranicar...............	6.6	*	--	--	--
Henry H. Bradley(e).............	--%	23.1	25.2	11.6	--
Adam H. Clammer(f)(l)...........	--	--	--	--	100.0
Mory Ejabat(c)	1.4	--	--	--	--
James H. Greene, Jr.(f)(l).......	--	--	--	--	100.0
Henry R. Kravis(f)(l)...........	--	--	--	--	--
Alexander Navab, Jr.(f)(l).......	--	--	--	--	100.0
Thomas R. Palmer(g)(m)..........	--	11.0	--	23.2	--
George R. Roberts(f)(l).........	--	--	--	--	--
Stephen L. Sauder(h)............	--	1.0	65.2	--	--
All directors and executive officers as a group (16 persons).......................	69.8	37.0	95.5	34.9	100.0
5% OWNERS:					
News-Press & Gazette Company(i)..	--	19.2	25.2	7.8	--
Advantage Capital Missouri Partners I, L.P.(j)...........	--	15.4	--	5.1	--
Advantage Capital Missouri Partners II, L.P.(j)..........	--	--	--	14.6	--
Pacific Capital, L.P.(k).........	--	14.2	--	--	--
BTI Ventures L.L.C.(f)(l)........	--	--	--	--	100.0
Kansas City Equity Partners I, L.P.(g)(m).....................	--	11.0	--	3.9	--
Kansas City Equity Partners Ventures II, L.P. (g)(m).......	--	--	--	19.4	--
White Pines Limited Partnership I(n)...............	--	11.5	--	--	--
LBI Group, Inc. (o)..............	--	--	--	20.5	--

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NAME AND ADDRESS OF BENEFICIAL OWNER(A)	PERCENTAGE OF TOTAL VOTING POWER OF FULLY DILUTED COMMON STOCK
DIRECTORS AND EXECUTIVE OFFICERS:	
Richard A. Jalkat..	*%
David E. Scott...	3.0
Donald H. Goldman..	
Gregory C. Lawhon..	*
Bradley A. Moline(d).....................................	*
Jeffrey D. Shackelford...................................	2.0
David W. Vranicar..	*
Henry H. Bradley(e)......................................	8.5
Adam H. Clammer(f)(l)....................................	51.2
Mory Ejabat..	*
James H. Greene, Jr.(f)(l)...............................	51.2
Henry R. Kravis..	51.2
Alexander Navab, Jr.(f)(l)...............................	51.2
Thomas R. Palmer(g)(m)...................................	3.5
George R. Roberts..	51.2
Stephen L. Sauder(h).....................................	9.1
All directors and executive officers as a group (16 persons)...	80.5
5% OWNERS:	
News-Press & Gazette Company(i)..........................	7.5
Advantage Capital Missouri Partners I, L.P.(j).............	3.2
Advantage Capital Missouri Partners II, L.P.(j)............	*
Pacific Capital, L.P.(k).................................	2.7
BTI Ventures L.L.C.(f)(l)................................	51.2
Kansas City Equity Partners I, L.P. (KCEP)(g)(m)...........	2.3
Kansas City Equity Partners Ventures II, L.P.	

(KCEP)(g)(m)	1.2
White Pines Limited Partnership I(n)	2.2
LBI Group, Inc.(o)	1.3

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* Less than one percent

(a) Beneficial ownership is determined in accordance with the SEC's rules and includes voting and investment power with respect to the shares.

(b) Includes options to purchase shares of the common stock, which were issued pursuant to our 1998 Stock Option Plan. Certain options are exercisable immediately on grant at an exercise price of $.001 per share, and vest over a four-year period, at a rate of 6.25% per quarter. All other options are exercisable at a price of $4.50 per share subject to a four-year vesting period, at a rate of 6.25% per quarter. Holders of exercised options have voting power with respect to all shares of common stock underlying the options. Upon termination of employment with us, we have the right to purchase all options which have not vested as of that date, subject to certain exceptions.

(c) In March 1999, Mr. Jalkat, chairman of our board of directors, agreed to purchase 26,667 shares of our common stock for $200,000 and Mr. Ejabat, a member of our board of directors, agreed to purchase 66,667 shares of our common stock for $500,000.

(d) Includes 19,275 shares of Series B Preferred Stock held by Mr. Moline's immediate family subject to options exercisable within 60 days of February 29, 2000

(e) Includes 1,648,438 shares of Series B Preferred Stock, 1,582,500 shares of Series C Preferred Stock and 222,222 shares of Series D Preferred Stock held by News-Press & Gazette Company.

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Mr. Bradley and his brother hold voting power of News-Press & Gazette Company. Also includes 329,690 shares of Series B Preferred Stock and 111,111 shares of Series D Preferred Stock held by various trusts and relatives of the Bradley family.

(f) All of the shares indicated are owned of record by BTI Ventures L.L.C. and are included because of Messrs. Clammer's, Greene's, Kravis', Navab's and Roberts' affiliation with BTI Ventures L.L.C. These individuals disclaim beneficial ownership of the shares within the meaning of Rule 13d-3 under the Exchange Act.

(g) Includes 945,108 shares of Series B Preferred Stock and 111,111 shares of Series D Preferred Stock held by Kansas City Equity Partners Ventures I and 555,556 shares of Series D Preferred Stock held by Kansas City Equity Partners Ventures II. Mr. Palmer holds voting power of Kansas City Equity Partners Ventures.

(h) Includes 65,937 shares of Series B Preferred Stock held by Mr. Sauder's father, 1,544,787 shares of Series C Preferred Stock held in trust by his wife and 1,000,000 shares of Series C Preferred Stock held in trust by S.L. Sauder LTP. L.L.P.

(i) The principal business address of News-Press & Gazette Company is 825 Edmond Street, St. Joseph, MO 64501.

(j) The principal business address of Advantage Capital Missouri Partners L.P. is 7733 Forsyth Boulevard, Suite 1850, St. Louis, MO 63105.

(k) The principal business address of Pacific Capital, L.P. is 2401 Plymouth Road, Suite B, Ann Arbor, MI 48105.

(l) The principal business address of BTI Ventures L.L.C. is 9 W. 57(th) Street, Suite 4200, New York, NY 10019.

(m) The principal business address of Kansas City Equity Partners is 233 West 47(th) Street, Kansas City, MO 64112.

(n) The principal business address of White Pines Limited Partnership I is 2401 Plymouth Road, Suite B, Ann Arbor, MI 48105.

(o) The principal business address of LBI Group, Inc. is 3 World Financial Center, 200 Vesey Street, New York, NY 10285.

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ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

SERIES D PREFERRED STOCK OFFERING

In July 1999, we completed a private placement of 2,222,222 shares of series D preferred stock at a purchase price of $4.50 per share for aggregate proceeds of approximately $10.0 million. The transaction was consummated pursuant to the purchasers rights agreement described below and the series D preferred stock purchase agreement. Under the series D preferred stock purchase agreement, NPG, a stockholder that owned in excess of 5% of our voting securities at the time of the series D preferred stock offering, purchased $1.0 million of series D preferred stock, and parties affiliated with NPG, including Henry H. Bradley, chairman of our board of directors at that time and of NPG, purchased $500,000 of series D preferred stock. Advantage Capital Missouri Partners I, L.P., a stockholder that owned in excess of 5% of our voting securities at the time of the series D preferred stock offering, purchased $655,000 of the series D preferred stock. In addition, Ian R. N. Bund, one of our directors at the time of the series D preferred stock offering, purchased $82,000 of the series D preferred stock. Affiliates of KCEP I and KCEP II also purchased $3.0 million of our series D preferred stock. Mr. Palmer, one of our directors at the time of the series D preferred stock offering, holds voting power of KCEP I and KCEP II.

SERIES F PREFERRED STOCK OFFERING

In August 1999, we issued and sold 13,333,334 shares of our series F preferred stock at a purchase price of $4.50 per share to BTI Ventures, L.L.C., an affiliate of KKR, for aggregate proceeds of $60.0 million. KKR received three seats on our then seven-seat board of directors. Additionally, on March 23, 2000, KKR exercised its options to purchase 5,263,158 shares of series F preferred stock at $4.75 per share and 5,000,000 shares of series F preferred stock at $5.00 per share. Giving effect to this exercise KKR's investment would have represented a 51.2% equity interest as of March 23, 2000. In connection with their exercise of these options, KKR received two additional seats on our eleven-seat board of directors.

In connection with the series F preferred stock offering, we repurchased 2,222,222 shares of our series C preferred stock from Stephen L. Sauder, a stockholder who owned more than 5% of our voting securities at the time of the series F preferred stock offering, for $10.0 million.

Also, in connection with the series F preferred stock offering, we converted each outstanding share of our series B preferred stock into one share of amended and restated series B preferred stock. In addition, the holders of series B preferred stock surrendered their existing redemption and participating liquidation preference in exchange for 0.2222 shares of our series E preferred stock. We redeemed the series E preferred stock issued to the series B preferred stock holders for a total of $8.6 million. The rights and preferences of the series B preferred stock were amended and restated to remove mandatory redemption rights and change the liquidation rights.